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Module Two

Comprehensive Level 2 Trading Techniques:

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MODULE 2

- Time & Sales part 3: How to Read & Trade Tape Resistance and Support

● Main Points:

- Our final tape reading lesson for now looks at how to recognize and trade support and resistance patterns.
- Remember using TA with our charts we expect 'support' and 'resistance' levels at the tops and bottoms of key trading ranges, right? Using Time & Sales is another, more powerful tool you can use to confirm breakouts, breakdowns and pivots.
- Practice all three lessons' worth of Time and Sales lessons to become an effective daytrader. There's more to cover, yet mastering these three lessons alone should significantly boost your trading profits, if practiced over the course of weeks and traded with effectively.
- What do you do when the tape is showing resistance? Either sell off your entire position, scale down (eg sell 1/3 to 1/2 of it while waiting for confirmation of trend change), or enter a new short as buyers start to dry up.
- In tape reading, always remember that you're looking for momentum (covered in the previous lesson) as well as the ratio of buyers to sellers (both quantity and share size). Keeping this ratio in mind as you see transactions scroll down the screen helps you determine net buying or selling that's going on, and make a higher-probability trading decision. **The key is to recognize the difference between a minor retracement and a genuine change in the trend direction using Time and Sales.**

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Note: The higher-%age bottom or top you're playing, the more likelihood a pivot is about to occur (eg if WCOM sold off by >5% on no bad news that morning by 10:30am).

L2: Doesn't tell you much here, slightly weighted in favor of sellers; indeterminate.

T&S: Trades going off fairly mixed here, a few bearish blocks, need to watch tape for a trend to emerge.

#2: Bottoming (or topping) out, about to pivot off a key support/resistance point.

After looking at the stocks' 2-day or 5-day chart to identify likely support/resistance levels, you watch T&S to see if, indeed, the traders respond to these "pivot points" where the stock either bounces off a bottom support level or breaks through a key resistance price.

These are most likely to occur at decade whole numbers, eg 30, 40, 50, 100 etc.; occur at 1/4 points for lower-priced (eg \$10-\$30) stocks. You hopefully already know this.

Here's what's new for Time & Sales: Watch to see if stops (or new buy orders) are being executed at these key support/resistance lines.

You'll likely see a flurry of orders occur at even numbers for stocks. Wait to see if the trading direction goes to the 15/16 or 1/16 (or 7/8...1/8) either above or below this key trading number, then buy or sell with the trend that emerges after stops.

Example: WCOM trades up to 46, you see trades go off faster in Time and Sales as a multitude of orders occur at this price; you see everything from 100-share trades to 10K blocks happen. Wait a second.

Now, let's see if the price strengthens or weakens at this key price level. If you see a bunch of trades begin to go off at 46 1/16th, then an occasional 46 1/8th etc, then go ahead and buy, with a stop set at 45 7/8.

If on the other hand it hits 46, then sellers pour in at 45 15/16, then you see 45 7/8, then up to 46, then back down to 45 7/8 etc (over a 3-5 minute period), then you know it may not have the momentum to break past 46. Look for a lower high/lower low pattern on the 1-minute chart. If it looks like it's weakening, fire off a short at 45 15/16. Your cover stop should be no more than 46 1/4. Maybe you set a cover target of 45 5/8, or even 45 1/4 if you're lucky. In and out, using your tape to guide your trading.

This is how we trade time and sales professionally.

WCOM									
Best Market									
OK									
WCOM + 77 1/16 b 77 o 77 1/16 215 x 17 10.7M 15:25									
MMID	Bid	B...	MMID	Ask	A...				
MASH	77	214	INCA	77 1/16	17	77	1/16	100	
SBSH	77	77	NFSC	77 1/16	7	77	1/16	2.50K	
MMSE	77	68	ISLD	77 1/16	7	77	1/16	300	
ISLD	77	57	COST	77 1/8	10	77	1/16	300	
MADF	77	52	MLCO	77 1/8	10	77	1/16	100	
BRUT	77	46	PWJC	77 3/16	1	77	1/16	300	
PERT	77	36	OLDE	77 1/4	10	77	1/16	100	
LEGG	77	35	PBCO	77 1/4	10	77	1/16	100	
MLCO	77	27	HRZG	77 1/4	2	77	1/16	100	
HRZG	77	19	ARCA	77 5/16	22	77	1/16	200	
PWJC	77	17	SLKC	77 3/8	10	77	1/16	100	
GSCO	77	10	MSCO	77 3/8	10	77	1/16	100	
NITE	77	10	JPM5	77 3/8	1	77	1/16	100	
ARCA	77	10	SBSH	77 7/16	10	77	1/16	100	
BTRD	77	10	DLJP	77 7/16	10	77	1/16	100	
COWN	77	10	MASH	77 1/2	3	77	1/16	100	
DLJP	77	10	NITE	77 9/16	10	77	1/16	100	
SWCO	77	10	PRUS	77 9/16	1	77	1/16	100	
PRUS	77	9	SHWD	77 9/16	1	77	1/16	100	
FCAP	77	9	SALI	77 5/8	9	77	1/16	100	
AGED	77	8	AANA	77 5/8	1	77	1/16	100	

Here's WCOM from 12/8/99 - we've shown you this chart before; look at it again from a Time & Sales perspective. It's a "Christmas Tree", green and red, no clear direction identified.

But, since our L2 shows a wall of buyers at 77, it's kind of a no-brainer scalp to bid 77 1/32 (or pay up the 1/16th) and sell it back at 1/4 or higher.

This is bouncing off a key support level, identified not on a chart, but on your L2 window. Note: these setups occur infrequently, but when you do you're probably pretty safe buying here, as Long As your stop is "I'll sell if the wall of buyers at 77 dries up to 4-5 participants (from the current 21+). Your stop is Not under 77, because this is a support level. It may well drop to 76 5/8 or less if it loses support at 77, so use the 77 L2 wall as your scalping support level.

Time and Sales should show some interest at the inside ask for you to stay in the trade; if everyone starts piling onto the buyers at 77 then it may well sell down. Note that MASH is using a bid size of 214 because he wants to be first in line ahead of solly SBSH w/77 size. ISLD buyers are 4th in line; I'd pay up retail and give up a spread rather than risk losing out entirely on the scalp because I wanted to wait behind several big market makers to buy. Or, split the spread with a 77 1/32 bid like I said (preferred).

This CHR pattern shows all buyers off 12 support in T&S, see everyone bid 12 1/16. Somebody sold a block at 40K, very bearish, but since we're trading 10Million shares today I don't worry too much.

Oh, they didn't tell you about that in the books? heh. **You need to evaluate the importance of blocks in relationship to the total share volume traded so far that day.** Re-read that.

Of course, if our volume was at 769K so far I'd worry a lot more about that 40K block.

Since all but one trade is going off at the inside ask, I'd expect WARR to stop selling and the stock to trade up to 12 1/16th x 1/8th. The point is, where does it go after that? 1/16th, clearing the spread, is only your first step. You want at least 1/4 point right?

Look at the column in the right for some additional tips.

CHRX		Best Market		P	T	OK
CHRX		+	12 1/16	b 12	a 12 1/16 81 x 7	10.5M 11:51
MMID	Bid	B...	MMID	Ask	A...	
ISLD	12	81	WARR	12 1/16	7	12 1/16 200
MASH	12	48	ISLD	12 1/8	33	12 1/16 1.00K
HRZG	12	43	INCA	12 1/8	30	12 1/16 400
SHWD	12	28	HRZG	12 1/8	20	12 1/16 500
INCA	12	15	SHWD	12 1/8	10	12 1/16 1.00K
REDI	12	11	LEGG	12 1/8	10	12 1/16 300
ARCA	12	5	REDI	12 1/8	6	12 1/16 1.00K
HMQT	12	3	MASH	12 1/8	5	12 1/16 500
SLKC	12	2	NITE	12 1/8	1	12 1/16 40.00
NITE	12	1	FBCO	12 1/8	1	12 1/16 1.00K
SELZ	11 15/16	10	SELZ	12 3/16	1	12 1/16 300
JANY	11 15/16	1	SBSH	12 3/16	1	12 1/16 1.00K
						12 1/16 100

Look at the second wave of action in Time and Sales to see if the support at 12 is going to hold. The L2 bands are really secondary, remember they are there to help you time when, exactly, you pull the trigger, and how to best route your order - will you try to preference one of the mm's, or will you just use a market or limit order? L2 is not for making trade entry decisions - it can fake you out.

The Time and Sales tells you when and if you should enter the trade, and when the best time to get out is.

Remember that, and you'll be ahead of 60% of the other daytraders out there.

Other tips about Tape Support and Resistance:

- **If you see at least 3 out-of-market blocks going off within the space of 20 or so trades**, watch to see if the crowd follows the direction, and be prepared to act. For example, if in the CHRX example above we see several 10K blocks going off at 12 1/8 or a 50K block at 12 3/16 we know an institutional trader is buying or selling ahead of the crowd.
- He may well be wrong, or, more likely, will continue to add to (or sell from) his position over the course of the trading day to work his order to the best price possible for his client. **Watch the Time and Sales window to see what effect, if any, these block trades have on the response of the other traders.**
- **The ratio of trades going off at the bid vs. ask, when weighted with the size of shares and relative speed of the tape**, is the barometer of the stocks' price direction. Learn to feel the ebb and flow of the trading waves by closely watching the trades go off in your T&S window, using a liquid (eg over 1.5Mshares/day-volume) stock.
- **Winning Hint** Many new daytraders cannot afford level 2 or time and sales, and tend to play under-\$20 stocks. You and the professional daytraders and market makers have a distinct advantage against them when using these trading tools. The play? **You might want to add a relatively inexpensive stock (but still good-volume, for insurance) to your L2 watchlist and see if you can gain a spread or two advantage against the 'budget trader' crowd by using the techniques we've covered in Module 2 using L2 and T&S.** Rookie daytraders tend to pay up both spreads, buying at the ask and selling at the bid; you can make a handsome profit by trading 500-1K shares of inexpensive stock like a market maker does, offering to buy at the inside bid then offering it back out a few spreads up a few minutes later. You'll have to learn which market maker is the axe, typically the heavyweights (SBSH MSCO MLCO GSCO) don't trade the cheaper stocks. You may see mms like PWJC etc.
- Look at a wide time and sales screen (like the INTC one in the previous lesson) to see the relative bid/ask sizes, and use that to help you determine the trading sentiment, whether bullish or bearish, at that point in time.
- Trading tape basics: remember to never fight the tape; the crowd sentiment is what you want to trade for a profit, hopefully ahead of the crowd, usually with it, but never against it. Don't short the skyrocketing stock, or buy the stock that's still tanking; use your T&S as a flashlight to see which path in the cave you should follow.